

## Message Text

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SUBJECT: FINANCE MINISTER PRESENTS 1977 BUDGET

REF: COLOMBO 4084

1. SUMMARY: WITH EXCEPTION OF PROPOSAL TO NATIONALIZE FOREIGN BANKS (REFTEL, 1977 BUDGET PRESENTATION SOMEWHAT ANTICLIMATIC. PROPOSALS TO CUT FLOUR PRICES AND INCREASE SUGAR RATION AND TEXTILE IMPORTS OBVIOUS PRE-ELECTION MOVES TO BENEFIT "COMMON MAN", BUT WERE HARDLY DRAMATIC. THREE PERCENT INCREASE IN TOTAL EXPENDITURES VERY MODEST WHILE ESTIMATED 8.7 PERCENT RISE IN REVENUES WITHIN REALM OF POSSIBLE. COST OF FLOUR PRICE CUTS AND OTHER MEASURES MAY END UP COSTING MORE THAN ESTIMATED, HOWEVER. FINANCE MINISTER GAVE FEW DETAILS ON FINANCING DEFICIT BEYOND EXPECTATION OF CONTINUED AID INFLOWS AND A RATHER VAGUE REFERENCE TO ONGOING NEGOTIATIONS FOR MORE OPEC MONEY. HE DID SAY THAT AN INCREASE IN OIL PRICES WOULD CONSIDERABLY CHANGE HIS BUDGET ESTIMATES. END SUMMARY.

2. IN TWO AND ONE HALF HOUR SPEECH BEFORE FULL NATIONAL ASSEMBLY AND PACKED PUBLIC GALLERIES ON NOVEMBER 3, FINANCE MINISTER FELIX BANDARANAIKE PRESENTED

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PRE-ELECTION BUDGET FOR 1977 (FISCAL AND CALENDAR

YEARS COINCIDE). MINISTER BEGAN BY READING INTRODUCTION IN SINHALA AND TAMIL BUT DELIVERED BULK OF ADDRESS IN ENGLISH. FIRST HALF OF SPEECH DEVOTED TO DETAILED ACCOUNT OF ECONOMIC DEVELOPMENTS SINCE 1970, WITH EMPHASIS ON ACCOMPLISHMENTS OF PRESENT GOVERNMENT. THIS FOLLOWED BY DESCRIPTION OF ECONOMIC AND FISCAL DEVELOPMENTS IN 1976 AND OUTLINE OF PROPOSED 1977 BUDGET. LAST HALF HOUR DEVOTED TO NEW ECONOMIC MEASURES TO BE IMPLEMENTED DURING 1977 AND ONLY REAL SURPRISE WAS PROPOSAL TO NATIONALIZE BRANCHES OF FOREIGN BANKS (REFTEL).

3. IN DISCUSSING CURRENT YEAR, MINISTER CITED CENTRAL BANK PROJECTION OF SLOWER REAL GNP GROWTH OF ONLY 2.5 PERCENT DUE TO LOWER AGRICULTURAL PRODUCTION AS RESULT OF DROUGHT. HE PREDICTED PADDY PRODUCTION WOULD BE EVEN LOWER THAN LAST YEAR'S POOR HARVEST AND SAID TEA AND COCONUT OUTPUT WOULD ALSO BE DOWN. A LOWER LEVEL OF IMPORTS WOULD LEAD TO AN IMPROVED BALANCE OF PAYMENTS SITUATION THIS YEAR, HOWEVER. WHILE ACKNOWLEDGING THAT MONEY SUPPLY HAD RISEN 25 PERCENT IN FIRST EIGHT MONTHS OF 1976, BECAUSE OF UNDER UTILIZATION OF IMPORT ALLOCATIONS AND BANK FINANCING OF ESTIMATED GOVERNMENT DEFICIT OF RS. 2,944 MILLION (DETAILS OF REVISED 1976 BUDGET ESTIMATES TO BE REPORTED SEPTTEL), HE SAID COST OF LIVING INCREASED ONLY 2 PERCENT DURING SAME PERIOD.

4. MINISTER PREDICTED MUCH BRIGHTER OUTLOOK FOR 1977 WITH REAL GNP RISING 4 PERCENT DUE TO RECOVERY OF AGRICULTURAL PRODUCTION. TEA AND RUBBER OUTPUT EXPECTED TO BE BACK AT NORMAL LEVELS AND PADDY AT VERY HIGH 70 TO 80 MILLION BUSHEL (POOR 1975 HARVEST AMOUNTED TO ONLY ABOUT 55 MILLION BUSHEL). ONLY COCONUT PRODUCTION IS EXPECTED TO REMAIN LOW. HIGHER VOLUME OF EXPORTS AND BETTER WORLD PRICES TO EASE BALANCE OF PAYMENTS PROBLEMS.

5. FOLLOWING IS COMPARISON OF DRAFT 1977 BUDGET ESTIMATES WITH REVISED ESTIMATES FOR 1976 IN MILLIONS OF SRI LANKA RUPEES:

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	1976	1977	CHANGE
NET CURRENT EXPENDITURES	5,500	5,827	327
NET CAPITAL EXPENDITURES	2,170	1,996	-174
SINKING FUNDS; AMORTIZATION	649	848	199
ADVANCE ACCOUNTS	100	--	-100
TOTAL EXPENDITURE	8,419	8,671	252
TOTAL REVENUE	5,475	5,951	476
BUDGET DEFICIT	2,944	2,720	-244

6. INCREASE IN CURRENT EXPENDITURES DUE TO RISE IN INTEREST PAYMENTS ON PUBLIC DEBT FROM RS. 835 MILLION IN 1976 TO RS. 1,019 MILLION IN 1977 AND 11 PERCENT INCREASE IN GOVERNMENT SALARIES. FOOD SUBSIDY ALLOCATION UP RS 107 MILLION TO RS. 1 BILLION, OR 17.2 PERCENT OF CURRENT EXPENDITURES. UNDER CAPITAL EXPENDITURES, IRRIGATION PROJECTS WILL RECEIVE HIGHEST PRIORITY WITH FISHERIES, UREA FERTILIZER PLANT AND OTHER INDUSTRIAL PROJECTS RECEIVING SIGNIFICANT FUNDING. DECENTRALIZED PORTION OF CAPITAL SPENDING, WHICH IS ALLOCATED FOR DEVELOPMENT PROJECTS ORIGINATING AT DISTRICT LEVEL, REDUCTED FROM RS. 350 MILLION IN 1976 TO RS. 300 MILLION NEXT YEAR. IMPROVED FORECASTING TECHNIQUES HAS ELIMINATED NEED FOR MARGIN OF RS. 100 UNDER ADVANCE ACCOUNTS. MINISTER CAUTIONED THAT IF OPEC RAISES OIL PRICES IN DECEMBER, ESTIMATED EXPENDITURES WILL CHANGE CONSIDERABLY.

7. ON REVENUE SIDE, 1977 ESTIMATES SHOW MODEST INCREASE IN SALES AND INCOME TAXES AND IN CUSTOMS DUTIES. MOST SIGNIFICANT INCREASE IS EXPECTED IN SALE OF FOREIGN EXCHANGE ENTITLEMENT CERTIFICATES WITH INCREASE OF RS. 250 MILLION, OR 23.8 PERCENT.

8. DEFICITS TO BE FINANCED AS NULLOWS (RS. MILLION):

	1976	1977		
DOMESTIC LOANS		1,410	1,300	
BORROWING FROM GOVERNMENT				
TRUST FUNDS	60	70		
COMMODITY AID COUNTERPART FUNDS			924	850
PROJECT LOANS AND GRANTS		350	500	
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TREASURY BILLS	200	---
TOTAL	2,944	2,720

9. FINANCE MINISTER DID NOT PROVIDE MUCH DETAIL ON FINANCING OF 1977 DEFICIT EXCEPT TO SAY HE EXPECTED FLOWS FROM TRADITIONAL AID GROUP TO REMAIN AT LEAST AT CURRENT LEVEL. MANY PEOPLE HAD EXPECTED HIM TO ANNOUNCE HE HAD OBTAINED NEW LOANS FROM OPEC COUNTRIES, BUT HE ONLY MENTIONED THAT NEGOTIATIONS WERE UNDERWAY.

10. AFTER HALF HOUR TEA BREAK, MINISTER FINALLY GOT AROUND TO WHAT EVERYONE HAD BEEN WAITING FOR: WHAT NEW PRICE AND TAX MEASURES WOULD HE PROPOSE? COMPARED WITH EXTENSIVE CHANGES INTRODUCED IN PREVIOUS BUDGET, THIS YEAR'S MEASURES WERE FAIRLY MODEST (WITH

EXCEPTION OF NATIONALIZATION OF FIREIGN BANKS) AND WERE AIMED AT REDUCING COST OF LIVING BEFORE ELECTIONS. PRICE OF WHEAT FLOUR REDUCED FROM RS. 0.86 TO RS. 0.80 PER POUND, BREAD PRICE CUT FROM RS. 0.80 TO RS. 0.75, AND SUGAR RATION INCREASED FROM THREE FOURTHS POUNDS TO ONE POUND PER WEEK AT SUBSIDIZED PRICE OF RS. 0.72 PER POUND (OFF-RATION PRICE UNCHANGED AT RS. 6 PER POUND). TEXTILES HAVE BEEN IN VERY SHORT SUPPLY SO MINISTER SAID IMPORTS WILL BE INCREASED. NO NEW TAXES WERE PROPOSED, BUT MINISTER PROMISED DRIVE TO COLLECT DEFAULT TAXES IN 1977. OTHER MEASURES INCLUDE ALLOWING SRI LANKAN RESIDENTS ABROAD TO OPEN FOREIGN EXCHANGE ACCOUNTS WITH LOCAL BANKS WITHOUT TAXES ON INTEREST OR BALANCE, WITHDRAWAL OF COMMONWEALTH PREFERENCES, AND PROMISE TO IMPLEMENT LAST YEAR'S ANNOUNCEMENTS OF VARIOUS WORKER BENEFITS.

11. COMMENT: COMPARED WITH WHAT SOME PEOPLE WERE EXPECTING, THIS PRE-ELECTION BUDGET WAS RATHER MODEST. REDUCTION IN FLOUR PICE AND INCREASED SUGAR RATION EXPECTED TO COST ADDITIONAL RS. 130 MILLION. NO FIGURE WAS PLACED ON COST OF INCRASED TEXTILE IMPORTS. ELIMINATION OF COMMONWEALTH PREFERENCES AND DRIVE TO COLLECT DEFAULT TAXES, HOWEVER, SHOULD PROVIDE SOME OFFSETTING INCOME WITHOUT LOSING ANY VOTES. OFF RATION SUGAR PRICE LEFT AT RS. 6 IN ORDER TO MAINTAIN UNCLASSIFIED

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INCENTIVE FOR DOMESTIC PRODUCERS. ALLOCATION OF FREE AND SUBSIDIZED RICE WAS NOT INCREASED. NEW FLOUR PRICE OF RS. 0.80 IS EQUIVALENT TO ABOUT \$200 PER METRIC TON (AT OFFICAL EXCHANGE RATE) WHICH IS APPROXIMATELY WHAT GSL IS PRESENTLY PAYING FOR FLOUR LANDED IN COLOMBO. ESTIMATED ADDITIONAL BUDGET COST OF RS. 70 MILLION IS PRESUMABLY FOR INCREASE IN CONSUMPTION. AT OFFICIAL EXCHANGE RATE AND CURRENT LANDED PRICE FOR FLOUR, RS. 70 MILLION WILL BUY ABOUT 40,000 METRIC TON. HOWEVER, WHEN FLOUR AND BREAD PRICES WERE REDUCED BY APPRIXIMATELY 20 PERCENT IN JULY, CONSUMPTION ROSE ABOUT 40 PERCENT. IF SAME PRICE ELASTICITY APPLICABLE TO LATEST PRICE CUTS OF A BIT MORE THAN 6 PERCENT, CONSUMPTION COULD RISE BY ROUGHLY 6,000 MT PER MONTH ADDING ABOUT 72,000 MT TO SRI LANKA'S IMPORT BILL AT A COST OF AROUND RS. 126 MILLION. REED

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